United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7424

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P/S

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

VINCENT K. HILTON and EDWARD G. HILTON, as Trustees under Indenture dated May 9, 1958 for the benefit of VINCENT K. HILTON: VINCENT K. HILTON and EDWARD G. HILTON, as Trustees under Indenture dated May 9, 1958 for the benefit of MARY G. HILTON; and EDWARD G. HILTON,

Plaintiffs-Appellants,

-against-

BROWN BROTHERS HARRIMAN & CO., et al.,

Defendants,

FIRST NATIONAL CITY BANK,

Defendant-Appellee.

APPEAL FROM UNITED STATES DISTRICT COURT,
SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANT-APPELLEE

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UNITED STATES COURT OF APPEALS
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VINCENT K. HILTON and EDWARD G. HILTON, as Trustees under Indenture dated May 9, 1958 for the benefit of VINCENT K. HILTON; VINCENT K. HILTON and EDWARD G. HILTON, as Trustees under Indenture dated May 9, 1958 for the benefit of MARY G. HILTON; and EDWARD G. HILTON,

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No. 75-7424

- -x

BRIEF OF DEFENDANT-APPELLEE

Statement of the Case

Appellants seek reversal of that portion of the District Court's order dismissing the complaint herein as against appellee First National City Bank ("Citibank")

By Findings and Conclusions dated June 19, 1975 (A-18)*

* The Appendix herein is cited as ("A")

the District Court, Hon. Marvin E. Frankel presiding, dismissed the complaint herein against Citibank and awarded appellants judgment by default against Inter-Mundis Capital Services Limited ("Inter Mundis"). The entire text of the Court's Findings and Conclusions is as follows:

> "By stipulation dated January 2, 1975, the parties have agreed upon the facts from which plaintiffs claim defendant First National City Bank is liable to them in the amount of $83,586.91. The facts so stipulated are incorporated herein as the court's findings. Upon the facts thus determined, plaintiffs' claim against said bank should and will be dismissed.
>
> "Applying the law of New York, which is agreed to govern the case, the court finds no basis for plaintiffs' claim. As an original proposition, it is scarcely appealing to urge that the settlor-beneficiaries, having delegated to the malefactor the power to act for them and having shed even minimal responsibility to look out for themselves, should be made whole by a bank, lacking knowledge even of the trusts' existence, for the routine honoring of its customer's checks. In any event, though there be no case squarely in point, the authorities reviewed in the briefs reflect principles defeating plaintiffs' claim. There was no such duty of inquiry as plaintiffs propose. The signature of Bush, fully authorized, was ample to negotiate the checks. Had the bank asked about that, it would have learned only that the course it took was proper.

> "A final judgment should be settled on notice (1) dismissing plaintiffs' claim against First National City Bank, with costs to the latter, and (2) awarding plaintiffs judgment on default against Inter Mundis."

In addition, appellants appear to seek appeal from the order of the District Court dated August 25, 1975, Hon. Marvin E. Frankel presiding, denying appellants' motion to vacate Citibank's Bill of Costs taxed on July 24, 1975.*

Facts

The parties hereto entered into a Stipulation As To Facts, dated January 2, 1975 and agreed that no witnesses would be called in either the prosecution or defense of appellants' claim, and waived trial by jury. Appellants settled their claims with all other defendants who appeared in this action. The following is a summary of the stipulated facts.

On March 12, 1971, there was in existence a trust set up by Indenture dated May 9, 1958, by and for the

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*Appellants appear to have abandoned this segment of their appeal in the appendix and brief, however, appellants' statement pursuant to Rule 30(b) F.R.App.P. appears to reflect an intention to raise the issue of Citibank's Bill of Costs.

benefit of Vincent K. Hilton, of which Vincent K. Hilton, Mary G. Hilton and James S. Bush were Trustees (A-9 and 10) and a trust set up by Indenture dated May 9, 1958, by and for the benefit of Mary G. Hilton, of which Vincent K. Hilton, Mary G. Hilton and James S. Bush were Trustees. (A-10)

By amendment dated September 15, 1967, which was in effect on March 12, 1971, Bush was authorized by the then Trustees of each said trust (A-10)

> "...to act alone as Trustee, as aforesaid, and to exercise the powers vested in the Trustees without obtaining the concurrence of any one or more of the Trustees at any time acting under said trust agreement..."

On March 12, 1971, each of said trusts owned 500 shares of Midland Ross Corporation, which were sold on that date through the New York Stock Exchange by Bacon, Stevenson & Co., a stockbroker, at the direction of Bush; on that date two checks drawn on its account at Citibank were given by Bacon, Stevenson & Co. to Bush as Trustee representing the net proceeds of said sales. Each check was in the amount of $15,072.98. (A-10) On the same date, the checks were endorsed by Bush, as Trustee, and deposited

by him in an account of Inter Mundis at Citibank; Citibank debited the account of Bacon, Stevenson & Co. and credited the account of Inter Mundis. (A-11) Inter Mundis was a corporation of which Bush was then President. (A-11)

There was no indebtedness or other amount owing from the trusts to Inter Mundis. (A-11)

Funds from this account were not disbursed to the trusts nor did the trusts otherwise receive any part of the funds represented by said checks, or the proceeds of said sales, except as the result of settlement of claims against others. (A-11)

Prior to the institution of this action, Citibank had no knowledge of the existence of said trusts, and had no copies of, nor had it seen any of the instruments which created said trusts, or amended the terms thereof. (A-12) Citibank has no records or other proof indicating that any inquiry was made by it when the checks in question were deposited. (A-12)

Appellants seek to hold Citibank liable for their Trustee's misappropriation.

ARGUMENT

I

THERE IS NO DUTY ON THE PART OF CITIBANK TO INQUIRE BEHIND A TRUSTEE'S ENDORSEMENT ON A CHECK

It has long been the decisional law of the State of New York, the Supreme Court of the United States and the Second Circuit Court of Appeals that a bank need not inquire behind a Trustee's endorsement of a check. The United States Supreme Court, in an action brought to charge the bank with liability for the proceeds of checks wrongfully misappropriated by a son who had power of attorney from his father (analogous to the Trustee having the power to deal with his principal's assets), held for the bank. The Court, speaking through Mr. Justice Holmes, principally based its decision on the fact that the checks in question being in proper form, it was not the responsibility of the bank to inquire behind them as to the purpose for which they were being applied. Mr. Justice Holmes said:

> "We do not perceive on what ground the petitioner [bank] could be held bound to assume that checks thus lawfully drawn were required to be held or used for one purpose rather than another." Empire Trust Co. v. Cahan, 274 U.S. 473, 479 (1927).

The Court reversed the lower courts which had held that though: "The petitioner [bank] had no notice other than what was given by the form of the checks" it was charged with knowledge of the misappropriation. (p. 478)

New York State has long upheld the same rule, the leading case being Bischoff v. Yorkville Bank, 218 N.Y. 106 (1916). In the Bischoff case, the Court of Appeals set forth the general proposition that a bank is not liable to a trust where the trustee misappropriates funds by check. In Bischoff, the Court held at p. 111:

> "A fiduciary may legally deposit the trust funds in a bank to his individual account and credit. Knowledge on the part of the bank of the nature of the funds received and credited does not affect the character of the act. The bank has the right to presume that the fiduciary will apply the funds to their proper purposes under the trust."

To the same effect is the position of the United States Court of Appeals for the Second Circuit. In Field v. Bankers Trust Company, 296 F.2d 109 (2nd Cir., 1961) cert. denied 369 U.S. 859 (1962), the Court held in favor of the bank where personal debts were paid with corporate funds. It was sought to hold the bank liable because it paid the checks in question. The court describing a past pattern

far more severe than our case held that even if the bank had had numerous dealings with misapplied checks and had benefited from the misappropriations, nonetheless

> "...the New York Court of Appeals recognized that 'to establish joint liability of the bank for the dereliction of the trustee the plaintiffs must prove that the bank gave to the wrongdoer such assistance as would make the bank a participant in the wrongdoing. Proof that the bank failed in care is insufficient.' Grace v. Corn Exchange Bank & Trust Co., 287 N.Y. at 102, 38 N.E. 2d at 452 (1941)." (p. 112)

The Bank here did not fail in care or give assistance to the wrongdoer. Also it had no course of dealings with misapplied checks, but solely the simultaneous transactions in question and there was no benefit to the Bank.

There may have been suggestions in older cases that a bank which has trust assets on deposit has some minimal contractual obligation to be alerted for glaring and repetitive misconduct (a position with which we do not agree). However, in the instant case there was no account of the trusts at Citibank, In fact, Citibank was not even aware of the trusts. (A-12) Citibank is thus one step further removed from a duty to the beneficiaries and can have no contractual duty.

However, even had the trust fund in question been on deposit at Citibank, Citibank would have been protected by statute and case law.

Apparently responsive to the uncertainties in the cases where the misappropriations were over a long period of time and the bank's involvement much more acute than in our case, New York State in 1948 adopted § 359-1 of the General Business Law:

> "¶ 359-1. Deposit of moneys by fiduciary. If a fiduciary makes a deposit in a bank to his personal credit of checks drawn by him upon an account against which he is empowered to sign as a fiduciary, or of checks drawn by him upon an account in the name of his principal if he is empowered to draw checks thereon, the bank receiving such deposit may assume, if acting in good faith and without actual knowledge to the contrary, that the funds so deposited by the fiduciary are funds to which the fiduciary is personally entitled. Nothing contained in this section shall be deemed to modify or otherwise affect any provision of section ninety-five of the negotiable instruments law, nor to relieve such bank from any liability imposed upon it by law to the extent of any payment or amount which such bank may receive for its benefit from any withdrawal or application of such funds so deposited. Added L. 1948, c. 866, ¶ 3, eff. April 6, 1948."

We suggest that this statute itself fully absolves Citibank in this case. Surely it is a distinction without a difference whether the fiduciary drew the checks in question (the language of the statute) or endorsed the checks. Similarly, whether the deposit is made to the trustee's personal credit or by his order to a corporation of which he is president, elevates form over substance.

The exceptions in 359-1 where the bank has actual knowledge or is not in good faith have no applicability here.

The Stipulation As To Facts is clear that Citibank had no actual knowledge of any misappropriation. Similarly, there is nothing in the Stipulation suggesting that Citibank was not "acting in good faith". "Good faith" being defined in a Uniform Commercial Code as follows:

> "Good faith means honesty in fact in the conduct or transaction concerned." Uniform Commercial Code, § 1-201 (19) (emphasis supplied)

The statute confirmed what had been the weight of law in New York. The general rule is set forth in New York Jurisprudence, Banks and Trust Companies, Vol. 5, § 441:

> "A bank in which trust funds are deposited is under no duty to exercise vigilance to protect the trust estate from possible embezzlement by the trustee who is authorized to act as such, and is not bound to inquire whether the fiduciary is applying such funds to the purposes of the trust unless the bank has some notice of misappropriation and with that notice aids in the misappropriation."

Even where the trust fund is on deposit in the bank and the bank is privy to the diversion, the New York Court of Appeals has held:

> "But one who relies upon the application of those principles must always affirmatively establish that the bank had notice or knowledge not only that the monies deposited were for a trust purpose but also that they were diverted from that purpose." [citing cases] Raymond Concrete Pile Co. v. Federation Bank, 288 N.Y. 452, 458 (1942), aff'd. on reargument 290 N.Y. 611 (1943)

The cases speak of the trust as being a depositor of the bank, one step closer than Citibank's relationship to appellants, but even there the bank's conduct must be flagrantly wrong to hold it liable. The law is summarized in Utica Metal Corp. v. Schecter Corp., 47 Misc. 2d 290 (Sup. Ct., Albany County 1965), modified 25 A. D. 2d 928 (1966):

"A review of the trust law principles applicable to banks in which trust funds are deposited adds perspective to the contending points of law. A bank in which trust funds are deposited is under no duty to exercise vigilance to protect the trust estate from possible misappropriation by the trustee who is authorized to act as such, and is not bound to inquire whether the fiduciary is applying such funds to the purposes of the trust, unless the bank has some notice of a threatened misappropriation and with that notice aids in the misappropriation. (Grace v. Corn Exch. Bank Trust Co., 287 N.Y. 94; Clarke v. Public Nat. Bank & Trust Co., 259 N.Y. 285.) Nor does a bank become privy to a misappropriation by merely paying or honoring checks of a depositor drawn upon his individual account in which there are, to the knowledge of the bank, credits created by deposits of trust funds. The law does not require the bank, under such facts, to assume the hazard of correctly reading in each check the purpose of the drawer, or, being ignorant of the purpose, to dishonor the check. The presumption is that the depositor will preserve or lawfully apply the trust funds. (Bischoff v. Yorkville Bank, 218 N.Y. 106.) These rules are understandable, for an unrestricted deposit of funds by a fiduciary is ordinarily regarded as general in character, and even the fact that the depositor adds to his name words descriptive of the fiduciary character in which he holds the funds, does not render the deposit a special one. (Matter of Wasserman v. Broderick, 140 Misc. 174.) Authority exists to the contrary, but not in this State. Practical considerations make adhesion to these principles advisable. The human participation required if the law were

> otherwise would render an intolerable burden upon financial institutions, in view of the complexity of the auditing functions of a commercial bank and the utilization of automation in that function." (pp. 292-293)

Citibank should not be held liable.

Authorities relied upon by appellants in support of their postulation of the Bank's liability are inapposite.

Finding no authority in point, appellants seek a basis for their arguments in Scott on Trusts, § 297.6 (App. Brief, p. 6) Appellants quote the opening sentence of that section. There is then a break in the quotation, a paragraph that begins on the next page is then quoted, more asterisks follow, a third sentence appearing three pages later is then quoted. Even the edited quotation gives appellants scant comfort in that the first paragraph speaks of "notice of breach of trust" which is not our situation; the second merely raises a question, and the third paragraph has to do with holders in due course without referring specifically to the bank exception.

There is no question that Bush had authority to negotiate trust instruments. The only test is whether Citibank acted in bad faith or had actual knowledge in accepting the check for deposit. The sentence following the last one quoted by appellants is:

> "As to defenses other than the lack of authority of the transferor to negotiate the instrument due to the fiduciary character in which he holds it, the transferee is a holder in due course unless he had actual knowledge of these defenses or acted in bad faith.[9]" [Footnote to supporting cases]. Scott on Trusts, p. 2422.

In fact, between appellants' excerpted first and second quotations, Scott makes this point:

> "It would seem accordingly, that the person tc whom the instrument is negotiated is not chargeable with notice that the transfer to him is in breach of trust unless he has actual knowledge of the breach of trust or knowledge of such facts that his action in taking the instrument amourts to bad faith." (p. 2418)

Startling is appellants' concession (App. Brief, p. 7) that under the Uniform Fiduciaries Act § 4 if a negotiable instrument is payable to a fiduciary an endorsee (technically Citibank is the drawee, not the endorsee), does not have a duty of inquiry. Appellants go on to say, however, that New York's provision to that effect contained in the Negotiable Instrument Law was repealed "by the adoption of the Uniform Commercial Code." (App. Brief, p. 8) Appellants are referring to Scott's discussion at pages 2422-2423 of his treatise including footnote 10. The second half of the footnote, omitted by appellants, states:

> "For a provision dealing generally with deposits by a fiduciary in a bank, see New York General Business Law, § 359-1."

The footnote goes on to refer the reader to §§ 324.2 and 324.4 of his treatise. Section 324.2 is a section entitled, Deposit in personal account, which states:

> "The mere fact, however, that it [the bank] has notice of the trust character of the money deposited is not sufficient to charge the bank with notice that the trustee is committing a breach of trust in making the deposit." (p. 2522)

Note, also, this language from the same section in an analogous situation:

> "So also if a trustee draws a check upon an account in the same or in another bank in his name as trustee and deposits it to his individual credit with the defendant bank, it has been held that the latter bank is not bound to inquire as to propriety of his conduct in making the deposit." (pp. 2523-2524)

Section 324.4 is headed, Application of deposit to depositor's individual indebtedness to the bank, a section not here relevant except for the fact that Scott criticizes Bischoff v. Yorkville Bank, 218 N.Y. 106 (1916) to the extent that that case had implied that once there had been payments by a trustee of trust funds to pay the

bank for personal debts, the bank was thereafter liable for all withdrawals from the trust account to the account of the trustee, a situation well beyond ours. Scott ended that section by saying, "In New York it is now provided by statute that..." and quoted Gen'l. Bus. Law § 359-1 in its entirety. A final quotation from Scott reflective of the "common law" states:

> "As has been pointed out, a bank in receiving and paying out trust funds has not the same duty of inquiry as is implied upon a purchaser of trust property.[7] Although a bank is not bound to accept deposits, it is under an obligation to a depositor to honor his checks, and if it refuses without justification to honor a check, it renders itself liable for damages to the depositor." [Footnote to cited case] (p. 2528)

Appellants' remaining "common law" argument quotes from 11 American Jurisprudence, 2d and similarly benefits from editing. The quotation commencing on page 8 of appellants' brief sets forth general agency law about notice and inquiry. As quoted in appellants' brief, the footnote number "16" which appeared above the fifth word "otherwise" in the treatise is omitted. Footnote 16 directed the reader to exceptions found in §§ 465, 467 and 468 of the same treatise. Section 467 sets forth as one of the exceptions the provisions of the Uniform Fiduciaries

Act which Scott said found their analogy in New York's now repealed Negotiable Instruments Law, which Scott then referenced to New York General Business Law, § 359-1. Furthermore, § 467 repeats the general rule as to the bank's duty:

> "If any negotiable instrument payable or indorsed to a fiduciary as such is indorsed by the fiduciary, or if any negotiable instrument payable or indorsed to his principal is indorsed by a fiduciary empowered to indorse such instrument on behalf of his principal, the indorsee is not bound to inquire as to whether the fiduciary is committing a breach of his obligation as fiduciary in indorsing or delivering the instrument, and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary, unless he takes the instrument with actual knowledge of such breach, or with knowledge of such facts that his action in taking the instrument amounts to bad faith." (p. 520)

The other reference is to § 468 which is headed Uniform Commercial Code, and cites to U.C.C. § 3-304, discussing the taking of an instrument signed by a fiduciary and stating that a person taking such an instrument even with knowledge of the fiduciary relationship is protected:

> "Under the Uniform Commercial Code, knowledge that any person negotiating the instrument is or was a fiduciary does not of itself give the purchaser notice of a defense or claim.

> "Such knowledge or notice does not prevent the holder from taking in due course, and he is free to take the instrument on the assumption that the fiduciary is acting properly." (p. 522)

Appellants' sub-point 2 of its Point I (App. Brief, p. 9), moved to what is termed the "closely analogous situation" and cite three cases, all decided before the 1948 enactment of General Business Law § 359-1, all substantially different from the instant situation and all going off on rather peculiar facts. Lee v. Corn Exchange Bank Trust Co. (App. Brief, p. 9), appears to assume that the bank had knowledge of the wronful transfers, which knowledge perhaps arose from the transfer of some 300 checks and appears to put great weight on the fact that the wife had power to operate the husband's personal account. The implications of this case are not at all clear but it certainly has no analogy to the instant situation.

Grace v. Corn Exchange Bank Trust Co. (App. Brief, p. 10) involved using trust funds to pay obligations to the bank, a situation not present in our case and clearly distinguishable. Furthermore, much of the opinion repeats the law favorably to Citibank only going off at the end on the fact that personal debts were paid to the bank and that funds out of the trust account were

transferred within the bank at least 24 times. We submit such a situation would now be governed by General Business Law § 359-1 and the results reached questionable.

Finally, the case of Newton v. Scott, (App. Brief, p. 10) is an appeal from a motion granting a nonsuit, and the facts are assumed most favorably to the appellants' side. The Court's decision merely sent the matter back for a trial of fact. More importantly, the Court found that officers of this rural bank had actual personal knowledge of the unusually large withdrawals from the trust funds which were on deposit in the bank.

The Court addressed itself only to the liability of the bank which had the trust account. They distinguished Newton v. Livingston County Trust Co., 243 App. Div. 632; aff'd., 268 N.Y. 557 (1935) brought by the same trustee in similar circumstances against a nondepository bank where the trustee had deposited the misappropriated funds. That action was dismissed at the end of plaintiff's case.

Appellants, utterly failing to prove there was a duty on the Bank to make inquiry, go on in this subdivision of their brief to assume such a duty and state that the Bank's failure to inquire imposes absolute

liability. They cite no authority in support of this point. In fact, the only case cited in that sub-section is an 1890 case involving corporate checks used for individual debts -- this is not our situation and even in the context of such an issue, the Second Circuit has reiterated the applicable trust law. See Field v. Bankers Trust Company, supra.

Appellants' quotation from 41 New York Jurisprudence, § 363 (App. Brief, p. 12) sets forth the law where there is notice that personal debts are being paid. There is no such notice in this case. Finally, the quotation from 5A New York Jurisprudence (App. Brief, p. 12), refers to situations where the bank knowingly participates in the fiduciary's diversion and there is no such participation in this case.

II

CITIBANK HAD AN OBLIGATION TO ITS DEPOSITOR BACON, STEVENSON & CO. TO HONOR CHECKS AS DRAWN

It is important to remember that Citibank's customer was not the trust fund but the brokerage house, Bacon, Stevenson & Co., which had sold the stock and drawn the two checks in question on its account at Citibank. It is elementary that Citibank has a contractual duty to its depositors to honor checks as drawn (Uniform Commercial

Code, § 4-402, Bank's Liability to Customer for Wrongful Dishonor). It is equally clear that the checks in question were drawn "to the order of [the Trustee]". (A 14 and 15)

When the checks were presented to the Bank, the Trustee had by endorsement ordered that they be paid to Inter Mundis. Apropos, therefore, is this language from the Bischoff case cited above:

> "The contract, arising by implication of law, from a general deposit of moneys in a bank is, that the bank will, whenever required, pay the money in such sums and to such persons as the depositor shall direct and designate." (pp. 112-113)

Because of the Bank's contractual obligation to its depositor, it would have dishonored the checks in question at its peril. The case is one where Citibank's responsibility is to its customer, the depositor; it is a stranger to the Trusts.

III

REQUIRING A BANK TO INQUIRE AS TO WHETHER AN INSTRUMENT PAYABLE TO A TRUSTEE AND ENDORSED BY HIM TO A THIRD PARTY IS FOR A PROPER TRUST PURPOSE WOULD BE AN INTOLERABLE BURDEN ON COMMERCE AND INCONSISTENT WITH EXISTING STANDARDS

Mr. Justice Holmes at page 480 of the Empire Trust Company case cited above, quoted approvingly from Whiting

v. Hudson Trust Co., 234 N.Y. 394, 406:

> "The transactions of banking in a great financial center are not to be clogged, or their pace slackened, by over-burdensome restriction."

If, for the purpose of analogy, we assume that the Trustee drew checks payable to Inter Mundis which were presented for deposit by Inter Mundis at Citibank, could there be any suggestion that the Bank must inquire as to the purpose or propriety of such a deposit? The answer must be "no".

Daily, countless checks drawn by fiduciaries go through the banking system. The bank is not expected to stop payment on each check while it makes inquiry as to the purpose intended. Certainly, a check imprinted "James Bush as Trustee" puts a bank on the same notice that trust funds are being used as a check drawn by a third party to the order of a trustee. In the former case, the bank is not required to inquire and there can be no distinction between that and the latter situation.

Whether endorsed by the trustee to the order of a third party or drawn by the trustee to the order of a third party, there was nothing on the check suggesting that the funds were for other than a proper purpose.

Viewed from another point of view, if the checks had been for a proper purpose and Citibank had refused the deposits pending inquiry, the trust would seek redress for either officious intermeddling or damages occasioned by wrongful dishonor.

IV

THE CHECKS WERE PROPERLY ENDORSED

Appellants also question the endorsements on the checks. Appellants first assume that the apparent words "et al" on the checks refer to others whose endorsements were required. The Uniform Commercial Code section in question refers to an instrument payable to the order of two or more persons and is silent on the issue of what "et al" means.

More importantly, U.C.C. § 3-403(1), Signature by Authorized Representative, states:

> "A signature may be made by an agent or other representative, and his authority to make it may be established as in other cases of representation."

Bush's authority is established by the fact that

> "...Bush was authorized by the then trustees of each said trust

'...to act alone as trustee, as aforesaid, and to exercise the powers vested in the Trustees without obtaining the concurrence of any one or more of the Trustees at any time acting under said trust agreement...'" (A-10)

It again is clear that it was these very beneficiaries as trustees, who delegated all responsibilities to Bush and whose misplaced trust caused the loss. They must bear the heaviest burden. Even appellants appear at page 16 to concede the circularity of their argument for there they say that Bush's sole signature should have put the Bank on an inquiry as to the authority of Bush. As we know from the stipulated facts, such inquiry would have revealed that Bush did have such authority.

Finally, appellants conclude with a citation to 10 New York Jurisprudence, Conversion § 43, referring to aiders and abettors (not our situation) being liable as converters, to the readily distinguishable Barden case having to do with checks made out to two payees and signed by one, without consent.

V

AN INQUIRY WOULD NOT HAVE DISCOVERED THE MISAPPROPRIATION

Passing over the question of the usefulness of an inquiry made to the unfaithful trustee or what the trust

instrument itself would have revealed, the Uniform Commercial Code provides that the trustee has prima facie authority to negotiate the check.

> "Sec. 3-117. Instruments Payable With Words of Description.
>
> An instrument made payable to a named person with the addition of words describing him
>
> * * *
>
> (b) as any other fiduciary for a specified person or purpose is payable to the payee and may be negotiated, discharged or enforced by him;..."

The trust instruments themselves create a conclusive presumption that any instrument executed by a trustee is proper. Article THIRTEENTH of each Trust states:

> "THIRTEENTH: The receipt of the Trustees for any money or things paid, transferred or delivered to them, shall be sufficient discharge and it shall not be the duty of any person making such payment, transfer or delivery, to see to the application thereof for the purposes of any trust created hereby. In no case shall any party dealing with the Trustees be obliged to see that the terms of this Trust Indenture have been complied with, or be obliged to inquire into the necessity or expediency of any act of the Trustees, or be obliged or privileged to inquire into any of the terms of this Trust Indenture, and every instrument executed by the Trustees shall be conclusive evidence in favor of every person relying upon or claiming

> under the same, (1) that, at the time of delivery thereof, any trust created by this Trust Indenture was in full force and effect; (2) that such instrument was executed in accordance with the trusts, conditions and limitations contained in this Trust Indenture or in some amendment thereof and binding upon all beneficiaries thereunder, and (3) that the Trustees were duly authorized and empowered to execute and deliver every such instrument."

Note particularly that one dealing with such an instrument shall not be "...privileged to inquire into any of the terms of this Trust Indenture..."

Therefore, even had Citibank wished to inquire as to the Trustee's power to direct trust funds to third parties they would be precluded by Article Thirteenth. The Bank would have also seen from the same Article that they were to treat the instruments as having been "duly authorized".

VI

APPELLANTS ARE BARRED FROM RECOVERY

At the time in question, March 12, 1971, Vincent and Mary Hilton were the beneficiaries of the two trusts in question. Other than James S. Bush, they were the only Trustees. (A-9 and 10)

By amendment some five and one-half years earlier, Vincent and Mary Hilton gave Bush authority to act alone

as Trustee. (A-10)

Note that the Hiltons did not resign as Trustees but merely abdicated their responsibilities, removing themselves from so simple a protection as being co-signers of checks. If any party contributed to the wrongdoing, it was the very beneficiaries. This position finds clear support in the Restatement (Second) of Trusts, (1959) § 184, Duty with Respect to Co-trustees.:

> "If there are several trustees each trustee is under a duty to the beneficiary to participate in the administration of the trust and to use reasonable care to prevent a co-trustee from committing a breach of trust or to compel a co-trustee to redress a breach of trust."

Comment a under that section could not more clearly speak to the present situation:

> "a. Scope of the Rule.
>
> It is ordinarily a breach of trust for a trustee to allow a co-trustee to have such control of the Trust property as to enable him to misappropriate it."

It has been said that beneficiaries protect themselves from the unfaithful trustee by requiring a bond, by confidence in the trustee's integrity, or by co-trustees.

Here, the first was waived, the second misplaced, and the third abdicated. The loss should not fall on a distant bank.

CONCLUSION

For the reasons above stated, the judgment below should be in all respects affirmed.

Dated: New York, N. Y.
October 21, 1975

Respectfully submitted,

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AFFIDAVIT OF SERVICE
BY MAIL

STATE OF NEW YORK)
) ss:
COUNTY OF NEW YORK)

Luigi P. De Maio, being duly sworn, says: that I am over the age of eighteen years and am not a party herein, and that on the 21st day of October, 1975, I served two copies of the within brief of defendant-appellee

upon the attorneys hereinafter named at the places hereinafter stated and set opposite their respective names by depositing the same, properly enclosed in a post-paid, properly addressed wrapper, in an official depository under the exclusive care and custody of the United States Post Office Department at 20 Exchange Place within the City and State of New York, directed to said attorneys at their respective addresses given below, which were designated by them for that purpose upon the preceding papers in this action, to wit:

John M. Friedman, Esq
2 Overhill Road
Scarsdale, New York

Sworn to before me this
22nd day of October, 1975

Notary Public
MICHAEL J. McALLISTER
Notary Public, State of New York
No. 31-7783935
Qualified in New York County
Commission Expires March 30, 1976